



Investment Office

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AGENDA ITEM 7b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** International Fixed Income RFP Request with "Spring-Fed Pool"
- II. PROGRAM:** Global Fixed Income
- III. RECOMMENDATION:** Staff requests approval to issue a Request for Proposal (RFP) with a "Spring-Fed Pool" feature for active international fixed income managers. The Investment Committee may decide to:
- A) Interview and score managers. Points would be allocated between the Investment Committee and staff for the recommended group of managers. OR
 - B) Delegate to staff scoring with staff returning to the Investment Committee with a final list of managers for approval, with the option to decide to interview at that time.

Wilshire Associates' opinion letter is shown in Attachment 1.

IV. ANALYSIS:

Background

CalPERS implemented the international fixed income program in May 1989, to provide diversification and achieve efficient frontier objectives in the CalPERS investment portfolio. The assets under management as of December 31, 2005 were approximately \$5.38 billion.

The international fixed income program currently consists of five managers, all of whom were hired in August 2000, and were funded as of September 2000 under one-year annual review contracts. Of these managers, two had existing contracts with CalPERS. Baring has been with CalPERS since October 1989, and Julius Baer since April 1994. The remaining three managers were new hires in August 2000. Subject to review by Legal and OSSD, CalPERS' current managers may not need to re-apply but work under their existing annual renewable contracts. These contracts allow for termination with thirty days notice.

At its October 17, 2005 meeting, the Investment Committee approved the Global Fixed Income Annual Plan. That plan, shown in Attachment 2 (page 15 of the power point presentation), listed a search for active international fixed income managers as one of Global Fixed Income investment policy and structure goals for 2005-2006. Issuing an RFP for active international fixed income managers is the next step in completing the Investment Committee's objective of capturing risk controlled excess returns in a more effective manner.

Manager Search Process

Staff expects that issuing a Spring-Fed Pool RFP for active international fixed income managers that meet institutional-quality standards is expected to yield ten to fifteen candidates that will constitute a focus group. Finalists (three to eight recommended firms) from this group will be brought to the Investment Committee for final approval (please see Attachment 3 for an RFP flowchart).

The universe of active international fixed income managers is quite compact. The RFP will allow participating managers to comment on how CalPERS may improve the structure of the program. It is expected that with staff and manager collaboration, the program can be enhanced. Any changes would be brought before the Investment Committee directly or through Policy Subcommittee. Additionally, the strategic relationship (how managers can aid in the creation of alpha for CalPERS internal programs) will gain greater prominence.

Staff may conduct onsite visits or interviews at CalPERS' headquarters for the managers submitting the highest scoring proposals.

The Investment Committee can decide if it wishes to interview finalist managers at the time staff presents its recommendation.

In consideration of the Board's policy on Board scoring, staff recommends that 250 points be allocated for staff and 100 points be allocated for the Investment Committee, to be applied in the event that the Committee decides to interview and score the bidders. The 250 points allocated to staff will consist of 150 points allocated to the scoring of the bidders' proposals and 100 points allocated to staff's onsite visits or interviews.

It is anticipated that most of the funding for the managers will come from CalPERS' existing active international fixed income managers. Retained existing managers will likely maintain at least a portion of their existing portfolios.

Criteria for Selection

The following criteria will be used for manager selection:

1. Depth of investment talent and a convincing strategy to retain top talent.
2. A well reasoned investment philosophy and process and the ability to demonstrate why it should add value over the benchmark.
3. A highly quantitative process for portfolio construction and risk control.
4. Experienced securities traders and evidence of ability to trade in a cost-effective manner for large institutional portfolios.
5. Competitive fee arrangements.
6. Strategic Relationship: a desire to work for CalPERS and deploy adequate and high caliber resources to aid in the creation of alpha for the internally run program.

In addition, care and attention will be given to the style and capitalization biases of the individual managers to avoid such biases in the Global Fixed Income portfolio.

Conclusion and Summary

- Issuing an RFP for active international fixed income managers is the next step in completing the Investment Committee's objective of capturing risk controlled excess returns in a more effective manner.
- A Spring-Fed Pool option is requested in the contracting process in order to facilitate the re-optimization of the portfolio in the future, as well as the inclusion of new managers who may qualify at a later date.
- Staff will seek Investment Committee approval for the recommended group of managers. The Investment Committee can decide to interview finalists.
- Staff will recommend to the Policy Subcommittee amendments to the current active international fixed income managers management policy.

V. STRATEGIC PLAN:

External investment manager performance is monitored by staff and reported to the Investment Committee per CalPERS Strategic Plan, Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions and Goal IX: Achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

The allocation to managers hired under this RFP will come from active international fixed income assets. Current staffing within Global Fixed Income is sufficient to complete this request for proposal. Onsite visits will require travel expense.

Staff is bringing this item to the Investment Committee in order to expand the Global Fixed Income opportunity set and enhance returns with a very low level of additional risk.

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